

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

| | | |
|---------------------------------|---|------------------|
| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 16716 |
| [REDACTED], |) | |
| |) | DECISION |
| Petitioner. |) | |
| _____ |) | |

On July 29, 2002, the Tax Discovery Bureau (Bureau) of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (petitioner), asserting income tax, penalty and interest in the amount of \$15,539 for the taxable years 1993, 1994 and 1998. The notice advised the petitioner that, if she disagreed with the deficiency, she could petition the Tax Commission for a redetermination.

On April 25, 2002, the petitioner filed a letter of protest that the Commission treated as a petition for redetermination. The Commission notified the petitioner she could meet with a Commissioner or a designee in an informal conference to discuss the deficiency determined by the Bureau, or, in the alternative, she could submit additional written information to show why the deficiency should be redetermined.

The petitioner requested a telephone informal conference. The petitioner submitted written information in advance of the conference. Pursuant to the petitioner's request, a telephone conference was conducted on November 21, 2002. After the conference, the petitioner submitted additional written information.

The information submitted by the petitioner was placed in and made a part of the Commission's file. The Commission has reviewed the file, is advised of its contents, and now issues this decision. For the reasons set forth below, the Commission affirms the deficiency determined by the Bureau.

This is a nonfiler case. The petitioner lives in Idaho Falls, Idaho and has possessed an Idaho driver's license since 1990. The petitioner has been registered to vote in Bonneville County since 1988, and she filed Idaho returns for the taxable years 1995 through 1997.

The [Redacted] audited the petitioner. The Service determined that the petitioner had taxable income for 1998 of approximately \$81,493. A majority of the income was comprised of non-employee compensation received from [Redacted] Idaho as reported on Form 1099-Misc. The [Redacted] rejected [Redacted] claims that the federal income tax was unconstitutional and assessed federal income tax.

The Tax Discovery Bureau received the audit conducted by the [Redacted]. The Bureau subsequently contacted the petitioner and stated that it appeared the petitioner might be required to file Idaho income tax returns for the years in question. The petitioner responded to the Bureau. She stated she was not required to file a return because the Idaho income tax was unconstitutional and her income was derived from nontaxable sources. Although the petitioner asserted she was not required to file returns, she submitted returns to the Bureau for the taxable years 1993 and 1994 with her written response. However, the returns could not be processed because they were not signed by the petitioner and failed to provide all the required information.

The Bureau determined the petitioner was an Idaho resident with a filing requirement. The Bureau relied upon the \$80,000 gross income reported in the federal audit and prepared a provisional return for the 1998 taxable year. Because a recognized Idaho Falls accounting company prepared the 1993 and 1994 unsigned returns, the Bureau used the income information provided on the returns to prepare provisional returns for the taxable years 1993 and 1994. The Bureau allowed personal exemptions, standard deductions, and grocery credits when it prepared the provisional returns. A credit for withholding tax was not provided since the petitioner did not submit any withholding

information. Also, although the petitioner claimed to have made a payment on the unprocessed 1994 return, a search of the Tax Commission's records revealed that the Commission did not receive the payment. The Bureau subsequently issued a Notice of Deficiency Determination on the date and in that amount indicated above.

The petitioner now seeks a redetermination of the deficiency on several grounds. The petitioner asserts she is not required to file Idaho tax returns or otherwise report her wages and compensation because she believes: (1) wages are not income; (2) the federal reserve notes she received for her labor are neither legal tender nor "income" subject to tax; (3) she does not have Idaho taxable income because her income does not derive from a "taxable source" listed in Internal Revenue Code § 861; and (4) the Commission failed to assess a claim and lien against her under the procedures set forth in the Uniform Commercial Code.

Most of the petitioner's stated grounds for redetermination are common tax protestor themes that state and federal courts have rejected time and time again. In Coleman v. Commissioner of Internal Revenue, 791 F.2d 68, Judge Easterbrook penned,

Some people believe with great fervor preposterous things that just happen to coincide with their self-interest. "Tax protesters" have convinced themselves that wages are not income, that only gold is money, that the Sixteenth Amendment is unconstitutional, and so on. These beliefs all lead--so tax protesters think--to the elimination of their obligation to pay taxes. The government may not prohibit the holding of these beliefs, but it may penalize people who act on them.

The petitioner asserts some of the same arguments discussed by Judge [Redacted]. As Judge [Redacted] stated, the petitioner's arguments are not supported by fact or law.

The Sixteenth Amendment provides Congress the power to tax income from whatever source derived. Under this broad Constitutional grant of authority, Congress has defined the term gross income to include compensation for services. Section 61 of the Internal Revenue Code provides that,

except as otherwise provided in Subtitle A of the Internal Revenue Code, "gross income means all income from whatever source derived." Section 63 of the Internal Revenue Code defines taxable income as "gross income minus the deductions allowed under this chapter."

Idaho has incorporated these federal provisions in its tax laws. Idaho tax law provides:

63-3002. Declaration of intent. It is the intent of the legislature by the adoption of this act, **insofar as possible to make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code** relating to the measurement of taxable income, to the end that the taxable income reported each taxable year by a taxpayer to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in the Idaho law; to achieve this result by the application of the various provisions of the Federal Internal Revenue Code relating to the definition of income, exceptions therefrom, deductions (personal and otherwise), accounting methods, taxation of trusts, estates, partnerships and corporations, basis and other pertinent provisions to gross income as defined therein, resulting in an amount called "taxable income" in the Internal Revenue Code, and then to impose the provisions of this act thereon to derive a sum called "Idaho taxable income"; **to impose a tax on residents of this state measured by Idaho taxable income wherever derived** and on the Idaho taxable income of nonresidents which is the result of activity within or derived from sources within this state. All of the foregoing is subject to modifications in Idaho law including, without limitation, modifications applicable to unitary groups of corporations, which include corporations incorporated outside the United States.

Idaho Code § 63-3002 (Emphasis added). Idaho Code §63-3022 defines the term "taxable income" to mean "'taxable income' as defined in section 63 of the Internal Revenue Code, adjusted as provided" in the Idaho Income Tax Act.

As incorporated in the Idaho Income Tax Act, an individual is subject to Idaho income tax on his income from all sources, unless express federal or state exemptions, adjustments, or limitations apply. The petitioner has not provided any information to establish that her income is exempt under an express federal or state law.

The petitioner asserts that only gain derived from capital (e.g. the sale of stocks) is subject to tax.

The petitioner argues that because her compensation is derived from her own labor (services) her compensation is not taxable. This argument is without merit.

The United States Supreme Court stated in Eisner v. Macomber, 252 U.S. 189 (1920), the term “income” is defined for income tax purposes as gain derived from capital, from labor, or from both. Since Macomber, the courts have consistently held that wages or “compensation for labor” is income for income tax purposes. Coleman v. Commissioner, 791 F.2d 68, 70 (7th Cir. 1986); United States v. Lawson, 670 F.2d 923 (10th Cir. 1982); United States v. Buras, 633 F.2d 1356 (9th Cir. 1980); Mitchell v. Agents of State, 105 Idaho 419, 425 (1983); State v. Staples, 112 Idaho 105, 107 (Ct. App. 1986); Parsons v. Idaho State Tax Com’n, 110 Idaho 572, 575 (Ct. App. 1986).

The courts also rejected the argument that compensation received in the form of Federal Reserve notes is not legal tender or “income” subject to tax. United States v. Condo, 741 F.2d 238, 239 (9th Cir. 1984); Jones v. Commissioner, 688 F.2d 17 (6th Cir. 1982); United States v. Rickman, 638 F.2d 182, 184 (10th Cir. 1980); United States v. Rifien, 577 F.2d 1111, 1112, (8th Cir. 1978); United States v. Daly, 481 F.2d 28, 30 (8th Cir.), *cert. denied* 414 U.S. 1064 (1973).

Alternatively, the petitioner argues that, even if the compensation she receives is “income,” her compensation is not taxable income because it is not derived from one of the “taxable sources” listed in Internal Revenue Code section 861. Section 861 of the Internal Revenue Code (IRC § 861) governs the taxation of income received by nonresident aliens and foreign corporations.

The petitioner argues that IRC § 861 exempts all income from taxation except income earned from certain sources. The courts rejected the petitioner’s argument that a citizen and resident of the United States is taxed only on income received from the sources identified in IRC § 861.

Apparently, petitioner believes that the only sources of income for purposes of section 61 are listed in section 861, that income from

sources within the United States is taxed only to nonresident aliens and foreign corporations pursuant to sections 871, 881, and 882, and that section 1461 is the only section of the Internal Revenue Code that makes anyone liable for the taxes imposed by sections 1 and 11.

Section 61(a) defines gross income generally as “all income from whatever source derived,” including, but not limited to, compensation for services and interest. Sec. 61(a)(1), (4). Section 63 defines and explains the computation of “taxable income”. Section 1 imposes an income tax on the taxable income of every individual who is a citizen or resident of the United States.

Habersham-Bey v. Commissioner, 78 T.C. 304, 309 (1982). *See also* Aiello v. Commissioner, T.C. Memo. 1995-40.

The federal district court in the eastern district of Wisconsin followed that same analysis in rejecting a taxpayer’s argument that the state of Wisconsin could only tax income derived from sources listed in IRC § 861.

Plaintiff argues further that his remuneration is exempt from taxation under 26 U.S.C. § 861(a)(3)(C)(ii), and thus excludable under 26 U.S.C. § 61 and, by reference, excludable under Wisconsin law. Suffice it to say that if plaintiff wished to avail himself of § 861(a)(3)(C)(ii), he would have to show that his work was done for a foreign office, or an office in a United States possession, of a domestic business entity. He has not alleged this, and it is clear from the record that he performed his work in the State of Wisconsin for Wisconsin employers.

Peth v. Breitzmann, 611 F. Supp 50 (E.D. Wis. 1985). *See also* Solomon v. Commissioner, T.C. Memo 1993-509 and Dacey v. Commissioner, T.C. Memo 1992-187.

The federal regulations specifically state that U.S. citizens (residents) are taxed on all of their income regardless of where the source is located.

In general, all citizens of the United States, wherever resident, and all resident alien individuals are liable to the income taxes imposed by

the Code whether the income is received from sources within or without the United States.

Treas. Reg. § 1.1-1(b). In contrast, nonresident aliens and foreign corporations are taxed only on income from certain sources within the United States. Consequently, it is necessary to identify the sources of income (and deductions) for nonresident aliens and foreign corporations. IRC § 861 and the accompanying regulations address this sourcing issue. Consistent with the authority noted above, IRC § 861 does not apply to resident citizens such as the petitioner in this case.

The petitioner's assertion that the Uniform Commercial Code or "Commercial Law" governs state tax matters also is misplaced. The United States Supreme Court has long recognized that the right to tax is a crucial attribute of state sovereignty. M'Culloch v. Maryland, 17 U.S. 316, 428 (1819). "The power to tax rests solely with the legislature, and is subject only to constitutional limitations." Richey v. Indiana Dept. Of State Revenue, 634 N.E. 2d, 375 (Ind. Tax Ct. 1994).

The Idaho legislature has enacted specific tax laws that govern the state's income tax. The Idaho income tax return filing requirements are set out in Idaho Code § 63-3030. Idaho Code § 63-3030(a)(1) sets forth the filing requirements for individuals who are residents of this state. A resident individual with gross income in excess of the minimum amount provided in Idaho Code § 63-3030(a)(1) is required to file an Idaho individual income tax return. In addition, he or she must pay Idaho income tax on their taxable income at the rate set forth in Idaho Code § 63-3024.

The statutory authorization for the Commission to determine an individual income tax deficiency and issue a Notice of Deficiency Determination is found in Idaho Code §§ 63-105(1), 63-3044, and 63-3045. Initially, the Commission conducts an audit or investigation to determine whether or not a deficiency exists. A deficiency in tax can result by, among other things, a person failing to file a tax return or failing to report taxable income. When the Commission finds that a person failed to file a tax return or to pay the proper amount of individual income tax, the

Commission issues a Notice of Deficiency Determination.

63-3045. NOTICE OF REDETERMINATION OR DEFICIENCY -- INTEREST. (1) (a) If, in the case of any taxpayer, the state tax commission determines that there is a deficiency in respect of the tax imposed by this title, the state tax commission shall, immediately upon discovery thereof, send notice of such deficiency to the taxpayer by registered or certified mail or by other commercial delivery . . .

Idaho Code § 63-3045 (2002). The Bureau followed these procedures when it issued the Notice of Deficiency Determination.

The information reported in the [Redacted], on Form 1099-Misc., and on the partially completed returns the petitioner filed, demonstrate the petitioner indeed was domiciled in Idaho, was an Idaho resident, and received income in excess of the statutory threshold amount. The Bureau correctly relied upon this information when it prepared provisional returns and determined that the petitioner had a tax deficiency for the taxable years in question.

When seeking a redetermination of the deficiency, the burden is on the petitioner to show that the tax deficiency is erroneous. It is well settled in Idaho that the deficiency determined by the Idaho State Tax Commission is presumed to be correct. Albertson's Inc. v. State, Dept. of Revenue, 106 Idaho 810, 814 (1984); Parsons v. Idaho State Tax Com'n, 110 Idaho 572, 574-575 n.2 (Ct. App. 1986).

The petitioner has failed to show that the deficiency determined by the Bureau was incorrect. Based on the information available, the Tax Commission finds the provisional returns to be a fair representation of the petitioner's taxable income for the taxable years in question and that the amounts shown due on the Notice of Deficiency Determination are true and correct.

WHEREFORE, the Notice of Deficiency Determination dated July 29, 2002, is hereby

APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following taxes, penalty, and interest.

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|-----------------|
| 1993 | \$ 821 | \$ 205 | \$ 572 | \$ 1,598 |
| 1994 | \$ 2,291 | \$ 573 | \$ 1,419 | \$ 4,283 |
| 1998 | \$ 6,425 | \$ 1,606 | \$ 1,838 | \$ 9,869 |
| | | | TOTAL DUE | <u>\$15,750</u> |

Interest is calculated through February 14, 2003, and will continue to accrue at the rate of \$2.15 per day until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioner's right to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2003.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2003, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]
[Redacted]

Receipt No. [Redacted]